

Message Text

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INFO OCT-01 ADP-00 EB-11 INR-10 SS-15 RSR-01 RSC-01 L-03

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FM AMEMBASSY JAKARTA

TO SECSTATE WASHDC 8019

INFO AMEMBASSY BANGKOK

AMEMBASSY KUALA LUMPUR

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AMEMBASSY SINGAPORE

AMEMBASSY TAIPEI

AMEMBASSY SEOUL

C O N F I D E N T I A L SECTION 1 OF 2 JAKARTA 8868

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E.O. 11652: GDS

TAGS: EGEN,ID

SUBJECT: SENATE HEARINGS ON OPIC

REF: STATE 141296

SUMMARY: REVIEW OF OPIC ACTIVITIES IN INDONESIA SHOWS
OPIC HAS SUBSTANTIAL ROLE IN U.S. INVESTOR ACTIVITY AND
MAKES POSITIVE CONTRIBUTION TO INDONESIAN ECONOMIC
DEVELOPMENT. INDONESIAN GOVERNMENT SENSITIVITIES IN
GENERAL NOT ENGAGED BY OPIC REQUIREMENTS OR OPIC EN-
COURAGEMENT OF U.S. PRIVATE INVESTMENT. APART FROM
SUGGESTING OPIC CONTINUE TO TAKE DEVELOPMENT-ORIENTED
STANCE IN CONSIDERING PROPOSED INVESTMENTS, MISSION
RECOMMENDS NO CHANGE IN METHOD OR SUBSTANCE OF OPIC PROGRAMS
IN INDONESIA. END SUMMARY.

1. U.S. FOREIGN POLICY OBJECTIVES IN INDONESIA ARE
DESIGNED SECURE THE ECONOMIC GROWTH AND POLITICAL
STABILITY OF THIS COUNTRY FOLLOWING CHAOTIC YEARS LEADING
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TO DEPOSING OF SUKARNO IN 1966. THESE OBJECTIVES ARE

PURSUED NOT ONLY THROUGH CONSORTIUM CONCESSIONAL ASSISTANCE (IGGI) BUT PRINCIPALLY THROUGH IMPACT OF PRIVATE INVESTMENT. THERE IS NO QUESTION THAT NOTWITHSTANDING THE IGGI ROLE IN PROVIDING SUPPORT TO GOI INVESTMENT NEEDS, THERE WOULD BE LITTLE PROSPECT OF SUSTAINED LONG-TERM GROWTH WITHOUT THE CONTINUING AND EXPANDING CONTRIBUTION OF FOREIGN PRIVATE INVESTMENT.

AMERICAN NON-PETROLEUM INVESTMENTS IN INDONESIA AS OF END CY 1972 TOTALED \$444 MILLION, OF WHICH 29 PERCENT OR \$130 MILLION WAS PROTECTED BY OPIC INSURANCE OR GUARANTIES. OF \$130 MILLION TOTAL, \$76 MILLION WAS IN EXTRACTIVE SECTOR AND \$56 MILLION IN OTHER SECTORS, MOSTLY MANUFACTURING. (FYI PETROLEUM INVESTORS NOT COVERED BY OPIC BECAUSE GOI CONSIDERS THEM CONTRACTORS AND NOT INVESTORS. END FYI.)

WHILE IT IS IMPOSSIBLE CATEGORICALLY TO STATE WHICH INVESTMENTS OF THIS \$130 MILLION WOULD NOT HAVE MATERIALIZED WITHOUT PIC PROTECTION, IT IS A REASONABLE ASSUMPTION THAT IN VIEW OF INDONESIA'S PRE-1966 HISTORY OF POLITICAL AND ECONOMIC INSTABILITY A SUBSTANTIAL PART OF THIS INVESTMENT WAS MADE AS A RESULT OF THE ADDITIONAL PROTECTION PROVIDED BY OPIC.

2. OUR COMMENTS WITH RESPECT TO SPECIFIC ISSUES NOTED PARAGRAPH THREE REFTEL ARE AS FOLLOWS:

A. CONTRIBUTION OF OPIC PROGRAMS TO FLOW OF U.S. PRIVATE FOREIGN INVESTMENT. COMMENT: AS NOTED ABOVE WHILE WE CANNOT SHOW HOW MANY U.S. INVESTORS IN ABSENCE OF OPIC GUARANTIES OR INSURANCE WOULD HAVE INVESTED, THE FIGURES SUGGEST SUBSTANTIAL CORRELATION BETWEEN DECISION TO INVEST AND AVAILABILITY OF OPIC PROTECTION. THIS MAY BE PARTICULARLY TRUE IN THE CASE OF LOAN GUARANTIES WHERE U.S. LENDERS ARE NOT IN ACTUAL MANAGEMENT OF THE INVESTMENT.

B. WHETHER LESS CONSIDERATION TO RISK MANAGEMENT WOULD HAVE RESULTED IN GREATER FLOW OF INVESTMENT. COMMENT: WE KNOW OF NO CASE WHERE INVESTMENT WAS NOT MADE
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AS RESULT APPLICATION OPIC RISK MANAGEMENT CONDITIONS. IN GENERAL WE WOULD PROPOSE OPIC CONTINUE TO TAKE A DEVELOPMENT-ORIENTED STANCE IN CRITERIA IT APPLIES TO PROPOSED INVESTMENTS. THIS DOES NOT IMPLY SACRIFICING OPIC RISK MANAGEMENT OR OPIC REVENUE CRITERIA, BUT IT DOES SUGGEST A BALANCE OF PRIORITIES IN FAVOR OF DEVELOPMENT NEEDS.

C. HAS ENCOURAGEMENT OF PRIVATE INVESTMENT RUN COUNTER TO NATIONAL SENSITIVITIES? COMMENT: WE HAVE NO EVIDENCE OF THIS BEING THE CASE. GOI RECOGNIZES THE ROLE OF PRIVATE INVESTMENT IN DEVELOPMENT OF THE COUNTRY, CONTINUES TO WELCOME FOREIGN CAPITAL AND IS CONCERNED TO MAINTAIN AND IMPROVE THE INVESTMENT CLIMATE. GOI HOWEVER IS BECOMING MORE SELECTIVE IN INVESTMENTS IT APPROVES AND LOOKS MORE CAREFULLY NOW TO EFFECT ON EXISTING OR POTENTIAL INDONESIAN SOURCES FOR SAME TYPE ACTIVITY. IT IS ALSO LOOKING MORE CLOSELY FOR A DEVELOPMENT IMPACT IN TERMS OF EMPLOYMENT AND IMPORT SUBSTITUTION. RECENT APPROVAL FOR OPIC INSURANCE OF LOAN BY CONTINENTAL ILLINOIS BANK TO P.T. INDOBUILDCO, A PURELY INDONESIAN FIRM (JAKARTA A-84, MAY 2, 1973), SUGGESTS WAYS IN WHICH OPIC CAN HELP BUILD UP DOMESTIC SECTOR AND OFFSET POTENTIAL NATIONAL SENSITIVITY AS FOREIGN INVESTMENT SHARE CONTINUES TO GROW.

D. EFFECT OF OPIC REQUIREMENT FOR SUBROGATION AND MANDATORY ARBITRATION. COMMENT: NEITHER SUBROGATION NOR MANDATORY ARBITRATION HAS PRESENTED PROBLEM UNDER THE USG/GOI 1967 INVESTMENT GUARANTY BILATERAL. WITH RESPECT CONSTRUCTION INSURANCE COVERING CONTRACTS BETWEEN GOI AND PRIVATE U.S. FIRMS HOWEVER, GOI QUESTIONS IMPLICATION OF PROPOSED CONSTRUCTION INSURANCE BILATERAL THAT GOI WILL FAIL TO MEET ITS OBLIGATIONS UNDER CONSTRUCTION CONTRACT ARBITRATION PROVISION. ACCORDINGLY, GOI HAS THUS FAR DECLINED TO SIGN CONSTRUCTION BILATERAL WHICH ESSENTIALLY IMPLIES GOI MAY REFUSE TO MEET ITS OBLIGATIONS. GOI NOTES NO OTHER FOREIGN GOVERNMENT GUARANTY PROGRAM REQUIRES SUCH IMPLIED ADMISSION. PROBLEM DOES NOT ARISE UNDER BASIC 1967 INVESTMENT GUARANTY BILATERAL WHICH COVERS INVESTMENTS IN WHICH GOI IS NOT A PARTY. NO
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ISSUES HAVE YET ARISEN INVOLVING USG THROUGH SUBROGATION OR ARBITRATION, BUT USG WOULD BE INVOLVED TO A DEGREE IN ANY CASE CONCERNING U.S. INVESTMENT.

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ACTION EA-14

INFO OCT-01 ADP-00 EB-11 INR-10 SS-15 RSR-01 RSC-01 L-03

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E. DO OPIC GUARANTIES CAUSE U.S. COMPANIES TO BE
LESS RESPONSIVE TO LOCAL SENSITIVITIES? COMMENT: WE
HAVE NO EVIDENCE THAT THIS IS OR IS NOT THE CASE.

F. IMPACT OF OPIC PROGRAMS ON EXPORTING AMERICAN
JOBS AND ON U.S. BALANCE OF PAYMENTS. COMMENT: WE SEE NO
INDICATIONS FROM THIS VANTAGE POINT OF OPIC-PROTECTED
INVESTMENTS HERE HAVING DISPLACED PROSPECTIVE INVESTMENTS
IN U.S. OR RESULTED IN SHUTDOWN OF PLANTS IN U.S. MANU-
FACTURING INVESTMENTS GENERALLY PRODUCE FOR DOMESTIC
CONSUMPTION. WHERE THEY REPRESENT NEW MARKET ENTRY BY
U.S. INVESTOR, SUCH ENTRY MIGHT NOT BE POSSIBLE FROM
PRODUCTION IN U.S. INCURRENT COMPETITIVE CONDITIONS.
MOST OF OPIC COVERAGE (\$76 MILLION OF TOTAL \$130 MILLION)
IS ISSUED FOR NATURAL RESOURCES DEVELOPMENT WHICH INVOLVES
LITTLE OR NO POTENTIAL FOR DISPLACEMENT U.S. JOBS. WE
HAVE NO EVIDENCE REGARDING U.S. BALANCE OF PAYMENTS
IMPACT, BUT WOULD EXPECT THAT EVENTUAL FLOW OF PAYMENTS
TO U.S. FROM INVESTMENTS IN INDONESIA WILL BE LARGE.

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G. RELATIVE MERITS EXTRACTIVE VERSUS MANUFACTURING
INVESTMENT. COMMENT: BOTH TYPES INVESTMENT CONTRIBUTE TO
INDONESIAN ECONOMIC DEVELOPMENT ALTHOUGH EXTRACTIVE SECTOR
MAY HAVE LONGER TERM IMPACT AND GREATER MULTIPLIER EFFECT.
BOTH TYPES INVESTMENT PROVIDE LOCAL EMPLOYMENT ALTHOUGH
MANUFACTURING BY VIRTUE LOCATION IN URBAN CENTERS TENDS

TO MEET EMPLOYMENT AT IMMEDIATE SITE OF NEED. ALSO, WHILE EXTRACTIVE RAW MATERIALS MAY BECOME VALUED U.S. OR OTHER DEVELOPED COUNTRY IMPORT, THIS DOES NOT DETRACT FROM IMPORTANCE TO INDONESIAN DOMESTIC ECONOMY (AND ASSISTANCE TO U.S. INVESTORS) OF OPIC COVERAGE FOR MANUFACTURING. MAJOR INVESTMENT IN EXTRACTIVE INDUSTRY MAY DEPEND MORE URGENTLY UPON AVAILABILITY OPIC GUARANTIES THAN MANUFACTURING WHICH MAY REPRESENT MORE LIMITED INVESTMENT. FOR EXAMPLE, IT IS DOUBTFUL WHETHER FREEPORT SULPHUR INVESTMENT (\$16.9 MILLION POLITICAL INSURANCE AND \$48 MILLION EXTENDED GUARANTY) WOULD HAVE BEEN MADE WITHOUT OPIC PROTECTION. LOCAL SENSITIVITIES MAY BE MORE PERTINENT CONSIDERATION WITH RESPECT EXTRACTIVE INVESTMENT WHERE INDONESIAN CONSTITUTION DEFINES BASIC RESOURCES OF COUNTRY AS CONTROLLED BY THE STATE FOR BENEFIT OF PEOPLE OF INDONESIA. ON THE OTHER HAND VISIBILITY OF FOREIGN INVESTMENT IN MANUFACTURING MUCH GREATER SINCE IT COMPETES LOCALLY AND IS GENERALLY LOCATED IN URBAN CENTERS.

ON BALANCE, MISSION SEES NO REASON TO STRESS MERITS OF ONE FIELD OVER THE OTHER. EACH HAS DISTINCT BENEFITS FOR INDONESIAN ECONOMIC DEVELOPMENT. EACH HAS ROLE IN U.S. INVESTOR ASSESSMENT OF BALANCE OF INVESTMENT OPPORTUNITIES.

NOTE THAT OPIC LENDING PROGRAM IS NOT ACTIVE HERE, PENDING RESOLUTION ISSUE OF INDONESIAN TAXES ON INTEREST PAYMENTS TO OPIC. OUTLOOK IS FAVORABLE FOR SETTLEMENT IN BILATERAL TAX CONVENTION NEGOTIATION IN AUGUST.
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